Fiscal Note 2011 Biennium

GOVERNOR'S OFFICE OF BUDGET AND PROGRAM PLANNING

Bill #	SB0503		**Title:**	Montana Economic Stimulus Act
Primary Sponsor:	Essmann, Jeff		**Status:**	As Introduced

- ☐ Significant Local Gov Impact
- ☐ Needs to be included in HB 2
- ☑ Technical Concerns
- ☐ Included in the Executive Budget
- ☑ Significant Long-Term Impacts
- ☐ Dedicated Revenue Form Attached

FISCAL SUMMARY

	FY 2010 Difference	FY 2011 Difference	FY 2012 Difference	FY 2013 Difference
Expenditures:				
General Fund	$86,166	$77,066	$78,795	$80,568
Revenue:				
General Fund	($139,000)	($293,000)	($330,000)	($375,000)
Net Impact-General Fund Balance:	($225,166)	($370,066)	($408,795)	($455,568)

Description of fiscal impact: This bill creates a credit against individual income tax or corporation license tax for a percentage of gains on the sale of stock in a Montana business that has been held for at least five years. This will reduce general fund revenue by about $0.3 million with the reduction growing each year. Half a year's reduction will occur in FY 2010

This bill also creates another credit and a deduction related to gains from the sale of assets acquired in 2009 through 2011. The revenue impacts of these provisions will occur after FY 2013.

FISCAL ANALYSIS

Assumptions:

1. This bill provides two income tax credits and an additional deduction for either income tax or corporation license tax. One of the credits and the deduction would not affect revenue until after FY 2013. The revenue impacts are discussed in the Long-Term Impacts Section.
2. Section 6 provides an individual income tax credit equal to 2% of gains on the sale of the assets of a Montana business (see Technical Note 1) or stock in a Montana corporation that was held for at least five years, plus an additional 0.2% for each additional year that the property is held, up to a maximum of 5% for property held 20 years or more. This credit would first be available for tax year 2009.
3. Gains from the sale of business assets that would be ineligible for the credit in Section 6 as sales of

property used in a taxpayer's trade or business are ordinary gains rather than capital gains (see Technical Note 2). Note that if the credit applies to this type of ordinary gains, additional credits would amount to approximately $1.2 million per year.

Capital Gains

4. Gains from the sale of stock are reported as capital gains on Line 13 of the individual income tax return. For 2007, there were 81,654 returns that reported a positive amount on Line 13; these returns reported $2,135.951 million in capital gains.
5. The HJR 2 income tax revenue estimate assumes growth rates for capital gains and other gains for 2008 through 2011. This fiscal note assumes that growth rates for 2012 will be the same as for 2011. The following table shows the calculation of positive capital gains through 2012:

	Capital Gains	
	$ million	% change
2007	$2,135.95	
2008	$1,787.32	-16.32%
2009	$1,477.21	-17.35%
2010	$1,648.98	11.63%
2011	$1,873.19	13.60%
2012	$2,127.88	13.60%

6. In 2000, the Department of Revenue did a study of capital gains reported on federal Schedule D filed with Montana returns for 1995 and 1998. In both years, gains on the sale of stock were 27% of the total. Of gains on stock where the Schedule D recorded both purchase and sale dates, 48% of gains were on sales where the stock had been held five years or more. The percentage of gains that are on the stock of Montana corporations is unknown. About 0.3% of national economic activity, as measured by GDP, takes place in Montana. Much of GDP is produced by multi-state corporations, but Montanans are more likely to hold stock in a Montana corporation (See Technical Note 1) than in a corporation doing business only in another state. This fiscal note assumes that this credit would be claimed on 0.039% (27% x 48% x 0.3%) of capital gains.
7. The average holding time for stock that had been held for at least five years was 19 years. This fiscal note assumes that this will continue to be the average holding period, so that the average credit on the sale of stock will be 4.8%.
8. The following table shows capital gains for which the credit would be claimed and credits for tax years 2009 through 2012:

	Capital Gains	
	0.39% of Gains	Credits
2009	$5.76	$0.28
2010	$6.43	$0.31
2011	$7.31	$0.35
2012	$8.30	$0.40

9. Credits would be claimed on returns filed after the end of each tax year, resulting in larger refunds and smaller payments with returns. Many of these credits are likely to be claimed by taxpayers who file on extension, by October 15. These taxpayers are required to pay tax due by April 15, but many taxpayers who file in October receive refunds. Thus, this fiscal note assumes that half of the revenue reduction from credits for each tax year will occur the following April and half will occur the following October. The following table shows the allocation of revenue reductions to fiscal years:

Tax Year	FY 2010	FY 2011	FY 2012	FY 2013
2009	$0.139	$0.139		
2010		$0.155	$0.155	
2011			$0.176	$0.176
2012				$0.199
Total	$0.139	$0.293	$0.330	$0.375

Administrative Costs

10. The credit in Section 6 is based on the gains from the sale of individual assets, rather than on the total amount of gains. The Department of Revenue would need to develop a new form for taxpayers to claim the credit and to process and verify this additional form. Section 4 provides for a new deduction that taxpayers would not be able to claim until 2015, but requires taxpayers to notify the department in 2009 through 2011 that they may be eligible for the deduction in the future. The department would need to develop a form for taxpayers to use for this notification, and process and retain forms submitted by taxpayers.
11. To process and verify credit claims and filings for future deductions, the department would need to hire an additional 1.0 FTE auditor beginning in FY 2010. Annual personnel costs would be $69,170. Annual operating costs would be $7,296 in FY 2010 and $7,896 in following years. One-time costs to set up a new employee would be $5,700 in FY 2010.
12. Costs to develop two new forms would be $4,000 in FY 2010. Changes to income tax returns and instructions would be made as part of the annual update process. Changes to the department's data processing system would be done by the software vendor as part of the annual maintenance contract, and testing would be done by department employees.

	FY 2010 Difference	FY 2011 Difference	FY 2012 Difference	FY 2013 Difference
Fiscal Impact:				
FTE	1.00	1.00	1.00	1.00
Expenditures:				
Personal Services	$69,170	$69,170	$70,899	$72,672
Operating Expenses	$11,296	$7,896	$7,896	$7,896
Equipment	$5,700	$0	$0	$0
TOTAL Expenditures	$86,166	$77,066	$78,795	$80,568
Funding of Expenditures:				
General Fund (01)	$86,166	$77,066	$78,795	$80,568
Revenues:				
General Fund (01)	($139,000)	($293,000)	($330,000)	($375,000)
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
General Fund (01)	($225,166)	($370,066)	($408,795)	($455,568)

Long-Term Impacts:

1. Section 3 of this bill provides an individual income tax credit for capital gains on the sale of a business or a portion of a business established in Montana between November 1, 2009 and January 1, 2012. This credit would equal 5% of the capital gains on assets that have been held for at least 10 years. Credits under Section 3 would first be claimed on returns for tax year 2019. It is impossible to reliably estimate the size or timing of possible credits.

2. Sections 4, 5, and 7 of this bill provide a deduction for either individual income tax or corporation license tax equal to 50% of the depreciation recapture on the sale after December 31, 2014, of any asset for which the taxpayer took advantage of the bonus depreciation provision of the American Recovery and Reinvestment Act (ARRA) and where at least 50% of the asset was fabricated or assembled in Montana. This deduction could first be claimed on returns for tax year 2015.

   Any revenue reduction from this provision would probably be spread over several years. Based on corporate tax returns from a previous period with bonus depreciation, 2003 through 2005, the Department of Revenue has estimated that the bonus depreciation provisions of the ARRA will reduce state revenue by about $6.5 million in the first year and will increase state revenue in later years with the increases ultimately totaling about $6.5 million. The deduction in Sections 4, 5, and 7 would at most cut these later revenue increases in half, resulting in a revenue reduction of at most $3.25 million spread over several years.

<u>Technical Notes:</u>

1. Section 6 provides a credit based on the sale of assets of a Montana business or stock of a Montana corporation. The terms "Montana business" and "Montana corporation" are not defined.
2. Sales of property used in a taxpayer's trade or business are ordinary gains rather than capital gains and thus would not be eligible for the credit in Section 6 as it is written. If the bill is amended to make the credit available for ordinary gains, additional credits each year would amount to $1.2 million.

Sponsor's Initials	*Date*	*Budget Director's Initials*	*Date*